

Before the  
FEDERAL COMMUNICATIONS COMMISSION  
Washington, DC 20554

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FEDERAL COMMUNICATIONS COMMISSION  
OFFICE OF THE SECRETARY

In the Matter of )

)  
Petition of U S WEST Communications, Inc. )  
for Forbearance from Regulation as a )  
Dominant Carrier in the Seattle, )  
Washington MSA )

CC Docket No. 99-1

PETITION OF U S WEST COMMUNICATIONS, INC. FOR FORBEARANCE

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## SUMMARY

U S WEST Communications, Inc. ("U S WEST"), pursuant to Section 10 of the Telecommunications Act of 1996 ("1996 Act"), hereby submits this Petition requesting that the Federal Communications Commission ("Commission") exercise its authority to forbear from regulating U S WEST as a dominant carrier in the provision of high capacity special access and dedicated transport for switched access ("high capacity services") in the Seattle, Washington Metropolitan Statistical Area ("MSA").

In its Petition, U S WEST demonstrates that the Seattle area market for high capacity services is robustly competitive. U S WEST faces intense competition from numerous resellers and established facilities-based competitors with substantial resources and extensive fiber networks. These established companies, which include the combined AT&T/TCG and MCI/MFS WorldCom companies, have access to financial resources equal to or greater than U S WEST's with which to fund expansion of their networks.

Following the approach that the Commission used to assess market power in the AT&T non-dominant proceeding and other proceedings, Professors Alfred E. Kahn and Timothy J. Tardiff conclude that U S WEST lacks market power in the Seattle area market for high capacity services. First, U S WEST has a steadily declining market share. The attached market analysis conducted by Quality Strategies demonstrates that competitive providers have captured almost 80 percent of the retail market for high capacity services. Moreover, it is important to

note that competitive providers' market share has been growing even more rapidly than the rapid growth in the demand for high capacity services in the Seattle area. Perhaps the most important trend statistic is the fact that, between the second and fourth quarter of 1997, competitive providers captured about two-thirds of the growth in demand for high capacity services.

Second, there is high demand elasticity. The customers that tend to purchase high capacity facilities – medium to large businesses, governmental entities and other carriers – are highly sensitive to price and other service characteristics. The ability of U S WEST's largest carrier customers to migrate high capacity traffic to their own affiliated fiber networks further increases their bargaining ability.

Third, there is high supply elasticity. Competitive providers have deployed more than 700 route miles of optical fiber in the Seattle MSA. These extensive fiber backbone networks have more than sufficient capacity to handle all of U S WEST's end user and transport traffic. Furthermore, approximately 61 percent of U S WEST's current high capacity demand is located within 100 feet of competitive providers' networks, which means that it could easily be absorbed by competitors in a relatively short time. Moreover, as the attached report prepared by POWER Engineers, Inc. demonstrates, competitive providers would not incur significant costs to extend their fiber networks to absorb the vast majority of U S WEST's current high capacity demand. In addition, the impressive growth of competitive providers' market share demonstrates that the cost of entry is not prohibitive.

Fourth, U S WEST does not enjoy an advantage in terms of its costs, structure, size and resources. Indeed, the combined A&T/TCG and MCI/MFS

WorldCom companies have a significant advantage in terms of scale economies and access to capital, not to mention the advantage of being able to provide interLATA services. The presence of competitive activity in the market while prices are dropping steadily is a strong indication that U S WEST does not have an insurmountable cost advantage in the market.

In light of U S WEST's lack of market power, Kahn and Tardiff conclude that competition, without dominant carrier regulation, is sufficient to constrain U S WEST's ability to impose anti-competitive prices and other terms and conditions of service. Therefore, U S WEST seeks forbearance from various dominant carrier regulations, including the requirement that U S WEST file tariffs on up to 15-days notice with cost support, price cap and rate of return regulation, and the requirement that U S WEST charge averaged rates throughout the Washington study area (i.e., the State of Washington).

U S WEST's Petition satisfies the three criteria of Section 10. First, because U S WEST lacks market power, dominant carrier regulation is not necessary to ensure that its rates and practices are just, reasonable and not unreasonably discriminatory. Moreover, other regulations (such as Sections 201 and 202 of the Communications Act of 1934, as amended) are sufficient to ensure that U S WEST does not attempt to charge unreasonable rates. Second, for these same reasons, dominant carrier regulation is not necessary to protect consumers. Third, forbearance from applying dominant carrier regulation to U S WEST's high capacity services is consistent with the public interest.

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PETITION OF U S WEST COMMUNICATIONS, INC. FOR FORBEARANCE

U S WEST Communications, Inc. ("U S WEST"), through counsel and pursuant to Section 10 of the Telecommunications Act of 1996 ("1996 Act"),<sup>1</sup> hereby submits this Petition requesting that the Federal Communications Commission ("Commission") exercise its authority to forbear from regulating U S WEST as a dominant carrier in the provision of high capacity special access and dedicated transport for switched access ("high capacity services")<sup>2</sup> in the Seattle, Washington Metropolitan Statistical Area ("MSA"). This includes forbearance from enforcing the Commission's Part 61 tariff rules as they apply to dominant carriers and any other rules affecting high capacity services which result in different regulatory treatment for dominant and non-dominant carriers.

U S WEST's Petition is limited in scope both geographically and the services

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<sup>1</sup> 47 U.S.C. § 160.

<sup>2</sup> Specifically, U S WEST seeks regulatory relief for special access and dedicated transport for switched access at DS1 and higher transmission levels (e.g., DS1, DS3 and OCn). No relief is sought for other interstate services, such as switched access and special access, and dedicated transport at DS0 and voice grade transmission levels.

covered by it. Furthermore, it does not present any novel questions of law or fact which might prolong the Commission's analysis. Therefore, U S WEST requests that the Commission treat this Petition in an expedited manner in order to bring the full benefits of competition to the Seattle area market at the earliest possible date.<sup>3</sup>

## I. INTRODUCTION

One of the key pro-competitive provisions Congress included in the 1996 Act is Section 10, which requires the Commission to forbear from applying any regulation or provision of the Act if the Commission determines that:

(1) enforcement is not necessary to ensure that rates and practices are just, reasonable, and not unreasonably discriminatory; (2) enforcement is not necessary to protect consumers; and (3) forbearance is consistent with the public interest.<sup>4</sup> In making the public interest determination, Section 10 requires that the Commission consider whether forbearance will promote competitive market conditions, including the extent to which forbearance will enhance competition.<sup>5</sup> The statutory imperative created by Section 10 reflects Congress's reasoned judgment that competition, not government regulation, should guide companies' behavior in competitive telecommunications markets.

In the sections which follow, U S WEST demonstrates that the market for

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<sup>3</sup> Under Section 10, in the absence of an extension, the Commission has one year to act on a forbearance petition before it is deemed to be granted. 47 U.S.C. § 160(c).

<sup>4</sup> 47 U.S.C. § 160(a)(1)-(3).

<sup>5</sup> 47 U.S.C. § 160(b).



high capacity services in the Seattle MSA is robustly competitive. U S WEST faces intense competition from both resellers and three established facilities-based competitors with substantial resources and extensive fiber networks. These established companies – AT&T Corp., which recently acquired Teleport Communications Group (collectively referred to as “AT&T/TCG”), Electric Lightwave, Inc. (“ELI”), and MCI WorldCom, Inc., which includes the previously acquired facilities of MFS and Brooks Fiber (“MCI/MFS WorldCom”) – have access to financial resources equal to or greater than U S WEST’s with which to fund expansion of their networks.<sup>6</sup> Equally as important, the recently completed mergers of TCG with AT&T Corp. and MCI with MFS WorldCom, have resulted in the two largest purchasers of high capacity services in Seattle (AT&T and MCI) having their own competitive fiber networks. U S WEST already is experiencing the effects of these mergers, as significant portions of these customers’ high capacity services have been migrated to the affiliated fiber networks.<sup>7</sup>

U S WEST’s steadily declining market share for high capacity services in the Seattle market supports the finding that U S WEST lacks market power. The attached market analysis conducted by Quality Strategies shows that competitive

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<sup>6</sup> In addition to these facilities-based competitors which were included in the Quality Strategies Report, several new entrants have entered, or have announced plans to, provide high capacity service in the Seattle area (e.g., Level 3, Winstar and NEXTLINK).

<sup>7</sup> Upon completion of the AT&T/TCG merger, AT&T Chairman Michael Armstrong said “We’re reducing our dependence on Bell companies for direct connections to businesses.” Armstrong also pledged “substantial resources” to continue building facilities in key markets, and has mentioned \$1 billion for TCG’s share of continuing AT&T capital expenses. Communications Daily, July 27, 1998.

providers have captured almost 80 percent of the retail market for high capacity services.<sup>8</sup> This is the most important market share statistic because the retail provider of high capacity services is the party that has the direct relationship with the customer. In fact, the customer may not even be aware of the identity of the carrier actually provisioning the underlying high capacity facilities. Therefore, the retail provider has a significant marketing advantage over the facilities provider and, in the case of U S WEST's competitors, the ability to offer a full service package to the customer that includes interLATA voice and data services.

In addition, expansion of competitive providers' business has been even more rapid than the impressive 12 percent growth in the demand for high capacity services in the Seattle market. During the period from the fourth quarter of 1994 to the fourth quarter of 1997, the competitive providers' market share of the "provider" segment (i.e., high capacity services ultimately purchased by end users) increased from less than 20 percent to 35 percent.<sup>9</sup> The competitive providers' market share of the "transport" segment (i.e., high capacity services purchased by carriers for transport) also is growing rapidly. Perhaps the most significant trend statistic is the fact that, between the second and fourth quarter of 1997, competitive providers captured 65 percent of the growth in demand of the provider segment and 78 percent of the growth in demand of the transport segment.<sup>10</sup> Share of growth is the

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<sup>8</sup> See Attachment A (Quality Strategies, U S WEST High Capacity Market Study, Seattle Metropolitan Statistical Area, dated Dec. 1, 1998, at 9 ("Quality Strategies Report")).

<sup>9</sup> Id. at 10.

<sup>10</sup> Id. at 9.

primary indicator of what a competitor's installed-base market share will look like in the future – and competitive providers in the Seattle area are capturing a majority share of market growth.

It also is important to consider the fact that existing competitive fiber networks have more than sufficient capacity to absorb the current demand for U S WEST's high capacity service.<sup>11</sup> The only real constraint on competitive providers expanding service to U S WEST's customers is the need to build facilities to connect these sites to their existing fiber backbone networks. In most cases, this is not an issue at all. Approximately 61 percent of U S WEST's current high capacity demand (DS1 equivalents) in the Seattle area is located within 100 feet of existing competitive provider fiber networks, which means that it can be absorbed easily and in a relatively short time.

Moreover, as the attached report prepared by POWER Engineers, Inc. ("PEI") demonstrates, competitive providers would not incur significant costs to extend their fiber networks to absorb the vast majority of U S WEST's current high capacity demand.<sup>12</sup> Specifically, competitive providers in Seattle can serve the almost 60 percent of U S WEST's high capacity customer locations within 1,000 feet of their existing fiber networks if they invest \$46 million,<sup>13</sup> and all of U S WEST's high capacity customer locations within 9,000 feet of their existing fiber networks if

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<sup>11</sup> See Attachment B (POWER Engineers, Inc., Seattle Cost Study & Model, Dec. 16, 1998 ("PEI Study" at 4)).

<sup>12</sup> Id. at 3.

<sup>13</sup> Id. These locations account for approximately 67% of all U S WEST's current high capacity demand in the Seattle area.

they invest approximately \$110 million.<sup>14</sup> Given that U S WEST's share of the Seattle area market for high capacity services is worth approximately \$52 million on an annual basis and the fact that the market has been growing recently at about 12 percent annually, it is economically rational to conclude that competitive fiber networks would be able to absorb most, if not all, of U S WEST's existing customers within a relatively short period of time.

The noted economists Alfred E. Kahn and Timothy J. Tardiff have analyzed the market share and competitive fiber network data for the Seattle area high capacity services market following the approach the Commission previously has used to assess market power for other services.<sup>15</sup> They conclude that "the market for high-capacity services in the Seattle area fully exhibits the indicia of competition that the Commission has prescribed."<sup>16</sup> In light of U S WEST's lack of market power, Kahn and Tardiff affirm that competition itself, without dominant carrier regulation, is sufficient to constrain U S WEST's ability to impose anti-competitive prices and other terms and conditions of services.

Indeed, Kahn and Tardiff conclude that continuing dominant carrier regulation of U S WEST's high capacity services in this highly-competitive

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<sup>14</sup> Id. These locations account for over 90% of U S WEST's current high capacity demand in the Seattle area.

<sup>15</sup> See Attachment C (Alfred E. Kahn and Timothy J. Tardiff, Economic Evaluation of High-Capacity Competition in Seattle, Dec. 22, 1998, at 1 ("Kahn and Tardiff Paper"))).

<sup>16</sup> Id.

environment would be “anti-competitive and injurious to consumers.”<sup>17</sup> U S WEST is the only carrier in the market that is required to file tariffs on up to 15-days notice and provide cost support.<sup>18</sup> Not only does this impose an unnecessary regulatory burden on U S WEST, but it gives competitive providers advance knowledge of U S WEST’s rates, thereby providing these competitors with an unfair opportunity to quickly implement a market response before the filed rates can even take effect. U S WEST also is the only carrier that is required to charge uniform rates throughout the entire State of Washington (i.e., the Washington study area), which means that U S WEST is prohibited from responding to competitive initiatives of other carriers.<sup>19</sup> The end result is that competitive providers can undercut U S WEST’s prices and cherry-pick the most desirable customers. The disparate regulation of U S WEST, as compared to every one of its competitors, places U S WEST at a severe competitive disadvantage in the high capacity services market in the Seattle MSA.

U S WEST’s Petition seeking relief from dominant carrier regulation in the Seattle area market for high capacity services satisfies the statutory criteria for forbearance. First, dominant carrier regulation of U S WEST’s high capacity

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<sup>17</sup> Id. at 3.

<sup>18</sup> See, generally, 47 C.F.R. §§ 61.38, 61.41-61.49.

<sup>19</sup> 47 C.F.R. § 69.3(e)(7) (access tariffs filed by price cap LECs “shall not contain charges for any access elements that are disaggregated or deaveraged within a study area that is used for purposes of jurisdictional separations”). Although U S WEST is permitted to establish density pricing zones for access elements, pricing for each density pricing zone must be uniform within a study area. 47 C.F.R. § 69.123.

services is not necessary to ensure that rates and practices are just, reasonable, and not unreasonably discriminatory. U S WEST does not have the power to control price in this market or the ability to act in a discriminatory manner. Second, because U S WEST cannot control prices or act in a discriminatory manner, the imposition of dominant carrier regulation on U S WEST's high capacity services simply is not needed to protect consumers in the Seattle MSA. Third, continuing to subject U S WEST's high capacity services in the Seattle area to dominant carrier regulation deprives customers of the benefits of true competition by imposing unnecessary regulatory costs on U S WEST and hampering its ability to quickly and effectively respond to competitive initiatives. In sum, continued dominant carrier regulation of U S WEST's high capacity services in the Seattle MSA harms the public interest and contravenes the pro-competitive goals underlying the 1996 Act.<sup>20</sup>

Finally, U S WEST emphasizes that it is not requesting that its high capacity services be deregulated – it is requesting only that the Commission exercise its Section 10 forbearance authority and regulate U S WEST as a non-dominant carrier in the high capacity services market in the Seattle MSA. As a non-dominant provider, U S WEST should be subject to permissive detariffing, which would allow, but not require, the filing of tariffs on one-day's notice with a presumption of lawfulness and without any cost support.<sup>21</sup> The Commission also should free

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<sup>20</sup> Joint Explanatory Statement of the Committee of Conference, S. Conf. Rep. No. 230, 104 Congress, 2d Session 113 (1996).

<sup>21</sup> In the Matter of Hyperion Telecommunications, Inc. Petition Requesting Forbearance, Memorandum Opinion and Order and Notice of Proposed Rulemaking, 12 FCC Rcd. 8596 (1997) (forbearing from requiring non-incumbent local exchange

U S WEST's high capacity services from price cap and rate of return regulation, which are appropriate only for dominant carrier services.<sup>22</sup> Moreover, the Commission should forbear from applying Section 69.3(e)(7) of its rules so that U S WEST can charge deaveraged rates within the Seattle MSA. The effect of granting U S WEST's Petition would be to place U S WEST on equal footing with all other competitors in the Seattle area market for high capacity services.

II. U S WEST SHOULD BE DECLARED NON-DOMINANT IN THE SEATTLE MARKET FOR HIGH CAPACITY SERVICES

U S WEST's classification as a dominant carrier in the high capacity services market dates back to 1980, when the Commission found that AT&T, including its 23 associated telephone companies, dominated the telephone market.<sup>23</sup> Since that time, the high capacity services market has evolved from a market containing only a few competitors into a highly-competitive market containing many competitors. Further, Congress adopted a number of market-opening requirements as part of the 1996 Act. These statutory requirements have had the effect of accelerating the competition that was already occurring in the high capacity services market and ensuring that the market remains competitive. By any measure, competitive telecommunications carriers are experiencing phenomenal growth and success in the Seattle MSA.

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carrier ("LEC") providers of exchange access services to file tariffs) ("CAP Forbearance Order").

<sup>22</sup> 47 C.F.R. §§ 61.41-61.49; 47 C.F.R. § 65.

<sup>23</sup> In the Matter of Policy and Rules Concerning Rates for Competitive Common Carrier Services and Facilities Authorizations Therefor, First Report and Order, 85 F.C.C.2d 1, 22-23 ¶¶ 60-63 (1980).

As demonstrated below, U S WEST cannot exercise market power in the Seattle area market for high capacity services. If U S WEST were to attempt to raise prices, either directly or through restricting output, its customers would quickly abandon U S WEST for one of the various competitive providers in the market. Yet U S WEST remains subject to the full panoply of dominant carrier regulations while all of its competitors enjoy the benefits of streamlined regulation. The Commission should exercise its Section 10 forbearance authority and regulate U S WEST in a manner commensurate with its non-dominant position in the high capacity services market.

A. Defining The Relevant Product And Geographic Market

The first step in analyzing market power is to determine the relevant product and geographic markets.<sup>24</sup> This approach allows for assessment of the market power of a particular carrier based on unique market situations by recognizing, for example, that “carriers may target particular types of customers, provide specialized services, or control independent facilities in specific geographic areas.”<sup>25</sup> In its Petition, U S WEST has carefully limited the scope of relief to the products and geographic area which are shown to be competitive in the attached market analysis and engineering report.

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<sup>24</sup> In the Matter of Motion of AT&T Corp. to be Reclassified as a Non-Dominant Carrier, Order, 11 FCC Rcd. 3271, 3285 ¶ 19 (1995) (“AT&T Reclassification Order”).

<sup>25</sup> In the Matter of COMSAT Corporation, Order and Notice of Proposed Rulemaking, 13 FCC Rcd. 14083, 14099-100 ¶ 27 (1998) (“Comsat Reclassification Order”).



# 1. High Capacity Services

The Commission has defined a relevant product market as a service or group of services for which there are no close demand substitutes.<sup>26</sup> In accordance with the Commission's analytical framework, U S WEST has defined the relevant product market as dedicated high capacity circuits provisioned at capacities of DS1 and above for purposes of the instant Petition. These high capacity circuits may be used to transmit voice, data, or both, and may utilize either wireline or wireless technology. While high capacity circuits may be provisioned at varying bandwidths using different technologies, they share the characteristic of offering business, government and carrier customers substantial bandwidth on a dedicated basis.

The Kahn and Tardiff Paper confirms that services provided to customers with usage sufficiently great to be economically served with high capacity facilities define the relevant product market.<sup>27</sup> In terms of the standard established by the Merger Guidelines, customers for lower capacity facilities would not shift their demands to high capacity facilities in response to a "small but significant" price increase in their current services, because the monthly cost of hooking them up for high capacity access is as much as six to seven times their current basic monthly

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<sup>26</sup> Id. ¶ 25 (citing LEC Classification Order ¶¶ 41, 54 (In the Matter of Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area and Policy and Rules Concerning the Interstate, Interexchange Marketplace, Second Report and Order in CC Docket No. 96-149 and Third Report and Order in CC Docket No. 96-61, 12 FCC Rcd. 15756 (1997) ("LEC Classification Order"))).

<sup>27</sup> Attachment C, Kahn and Tardiff Paper at 3.

charges.<sup>28</sup> Because high capacity access and low capacity access are not substitutable on the demand side, low capacity services are in a separate product market.<sup>29</sup>

2. Geographic Scope of the Market for Dedicated High Capacity Services

As the Commission recently explained, a “relevant geographic market aggregates into one market those consumers with similar choices regarding a particular good or service in the same geographical area.”<sup>30</sup> U S WEST’s Section 10 Petition seeks regulatory relief only for the Seattle MSA because within this market there is an identifiable class of competitors providing high capacity services. Kahn and Tardiff note that the geographic scope for high capacity facilities from the supply side is the metropolitan area.<sup>31</sup> A metropolitan area tends to be the area within which a provider announces the availability of its service and the area within which a provider can expand in a timely fashion to offer services to a

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<sup>28</sup> Id. at 4 (citing Merger Guidelines).

<sup>29</sup> Id. at 4-5.

<sup>30</sup> Comsat Reclassification Order ¶ 27; see also In the Applications of NYNEX Corporation and Bell Atlantic Corporation For Consent to Transfer Control of NYNEX Corporation and Its Subsidiaries, Memorandum Opinion and Order, 12 FCC Rcd. 19985, 20016-17 ¶ 54 (defining relevant geographic area as “an area in which all customers in that area will likely face the same competitive alternatives” for a relevant service) (“Bell Atlantic/NYNEX Order”).

<sup>31</sup> Attachment C, Kahn and Tardiff Paper at 5. This definition is consistent with the use of the MSA as the relevant geographic market. The U.S. Census Bureau describes the general concept of an MSA as “that of a core area containing a large population nucleus, together with adjacent communities having a high degree of economic and social integration with that core.” <http://www.census.gov/population/www/estimates/aboutmetro.htm>.

growing number of locations.<sup>32</sup> In this case, the PEI Study demonstrates that competitors can economically expand to serve 60 percent of U S WEST's existing high capacity customer locations in the Seattle area (representing 67 percent of U S WEST's existing high capacity demand) within 18 to 24 months.<sup>33</sup>

U S WEST also limits the geographic scope of its Petition so that it covers only that area for which U S WEST has irrefutable evidence of competition.<sup>34</sup> The attached Quality Strategies Report (Attachment A) shows that U S WEST faces intense competition from established facilities-based providers in the provisioning of high capacity services in the Seattle MSA. In fact, competitive providers have substantial market share and more than sufficient network capacity to absorb U S WEST's existing business should U S WEST attempt to exercise market power. In addition, the PEI Study demonstrates that competitive providers could expand their existing networks at relatively little cost to serve U S WEST's existing high capacity customers in the Seattle area. Based on this evidence, Kahn and Tardiff conclude that the Seattle area market for high capacity services is highly competitive and that U S WEST does not have the ability to exercise market power.<sup>35</sup>

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<sup>32</sup> Attachment C, Kahn and Tardiff Paper at 5.

<sup>33</sup> Attachment B, PEI Study at 3.

<sup>34</sup> This in no way implies that there is an absence of competition in other parts of Washington served by U S WEST. In fact, U S WEST faces significant competition in Tacoma, Spokane, and Vancouver, Washington and will be requesting regulatory parity with other providers of high capacity service serving these areas in a subsequent filing with the Washington Department of Utilities and Transportation.

<sup>35</sup> Attachment C, Kahn and Tardiff Paper at 2-3.

B. The Seattle Market For High Capacity Services  
Is Robustly Competitive

In assessing market power, the Commission is guided by well-accepted principles of antitrust analysis to determine whether a carrier is dominant in the relevant product and geographic market.<sup>36</sup> The Commission has relied on several factors as part of this analysis, including: (i) market participants; (ii) market share; (iii) the demand elasticity of customers; (iv) the supply elasticity of the market; and (v) the carrier's cost, structure, size and resources. Assessment of these general characteristics of the Seattle area market for high capacity services demonstrates that U S WEST cannot exercise market power.

1. Market Participants

The Seattle market for high capacity services is characterized by a number of established competitors with substantial resources. The following is a brief description of the facilities-based market participants included in the Quality Strategies market analysis:

AT&T/TCG has over 380 route miles in the Seattle area and approximately 115 buildings are connected to its network.<sup>37</sup> With the recent merger of TCG and AT&T, AT&T already has begun the process of migrating its dedicated high capacity traffic from U S WEST to TCG.

ELI has over 150 route miles of fiber in the Seattle area and 70 buildings on

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<sup>36</sup> Comsat Reclassification Order, 13 FCC Rcd. at 14118-119 ¶ 67.

<sup>37</sup> Attachment A, Quality Strategies Report at 20.

its network.<sup>38</sup> Far from being a start-up, ELI is a subsidiary of Citizens Utilities Company, a large utility company and full-service telecommunications services provider.<sup>39</sup> Moreover, ELI is a rapidly growing company.<sup>40</sup> In August 1998, ELI announced plans to create the largest, ringed SONET network in the western United States, connecting Seattle to Portland, Sacramento, Los Angeles, Las Vegas, Phoenix and numerous other western cities.<sup>41</sup>

MCI/MFS WorldCom has over 170 route miles of fiber in the Seattle area and over 100 “lit” buildings on its network.<sup>42</sup> In addition to the competitors included in the Quality Strategies Report, a number of other facilities-based competitors have entered, or have announced plans to enter, the Seattle area market for high capacity services. For example, in September 1998, fixed wireless provider Advanced Radio Telecom Corporation (“ART”) announced that it had launched its new broadband metropolitan area network in the Seattle area and successfully converted 85% of its pilot customers into commercial customers. ART stated that, by the end of September 1998, it already had 14 buildings on its Seattle

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<sup>38</sup> Id.

<sup>39</sup> <http://www.eli.net/history.html>. Citizens Utilities had revenues of \$1.4 billion in 1997, an increase of 8% over 1996. <http://www.czn.net/PressReleases/pr031298.html>.

<sup>40</sup> In 1997 alone, ELI’s revenues increased 95 percent, from \$31.3 million to \$61.1 million. ELI’s network services revenue (which includes private line services) increased from \$18.7 million in 1996 to \$33.5 million in 1997, an increase of 78.9 percent. In addition, ELI’s route miles increased from 1,428 to 2,494, an increase of 74.6 percent, and its fiber miles increased from 97,665 miles to 140,812 miles, an increase of 44.2 percent. <http://www.eli.net/annual.pdf>.

<sup>41</sup> <http://www.czn.net/pressreleases/p082598a.html>.

<sup>42</sup> Attachment A, Quality Strategies Report at 20.

metropolitan area network.<sup>43</sup> Level 3 Communications, Inc. announced in November that it will begin providing telecommunications services in Seattle as part of its national city roll-out. The initial products being offered to business customers include private line services.<sup>44</sup> Moreover, NEXTLINK has announced that it expects to launch switched services in Seattle in the first half of 1999,<sup>45</sup> and GST Telecommunications, Inc. ("GST") expects to connect Seattle with its large regional network (which also connects more than 13 other cities including Portland, Vancouver, San Francisco, Los Angeles, Phoenix, Honolulu) in early 1999.<sup>46</sup> In addition, fixed wireless providers Winstar and Teligent hold licenses covering the Seattle area and plan to offer high capacity services to business customers.<sup>47</sup>

Clearly, none of these providers of high capacity services can be classified as "start-up" companies. According to Quality Strategies, ELI and AT&T/TCG entered the market in 1993, and MCI/MFS WorldCom entered the market in 1994. Further, these companies have access to financial resources equal to or greater than U S WEST's that can be used to fund expansion of their networks serving Seattle customers of high capacity services. For example, in the past two years, WorldCom acquired two competitive providers, MFS and Brooks Fiber, for a combined price of

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<sup>43</sup> Advanced Radio Telecom Press Release, November 10, 1998 "ART Reports Third Quarter Earnings".

<sup>44</sup> [http://www.l3.com/company/nov0998\\_seatt.html](http://www.l3.com/company/nov0998_seatt.html). Level 3 is building the first international network based on Internet Protocol technology.

<sup>45</sup> [http://www.nextlink.net/xpage/xpr\\_corp\\_102798.html](http://www.nextlink.net/xpage/xpr_corp_102798.html).

<sup>46</sup> <http://www.gstcorp.com/press/gen125.html>.

<sup>47</sup> [http://www.teligent.net/default\\_about.asp](http://www.teligent.net/default_about.asp).

\$16.4 billion – an amount almost identical to what SBC paid to acquire Pacific Telesis. MCI/MFS WorldCom has 22 million customers and annual revenues of \$30 billion.<sup>48</sup> Similarly, AT&T recently acquired TCG at a cost of \$11.3 billion and announced its intention to acquire TCI at a cost of \$48 billion. The sheer size of the combined AT&T/TCG and MCI/MFS WorldCom companies dwarfs U S WEST.

Equally as important, the recently completed mergers of TCG with AT&T and MCI with MFS WorldCom, have resulted in the largest purchasers of high capacity services in Seattle having their own competitive fiber networks. [verify] This is a significant development, given that AT&T/TCG and MCI/MFS WorldCom account for approximately 40 percent of U S WEST's existing demand for high capacity service in the Seattle MSA. In fact, U S WEST already is experiencing the effects of these mergers, as significant portions of these customers' high capacity services are migrated to the affiliated competitive fiber networks. For example, now that AT&T has completed its merger with TCG, AT&T has pledged to further reduce its dependence on U S WEST and other Bell companies and to commit "substantial resources" to continue building TCG facilities.<sup>49</sup>

Now that AT&T and MCI have access to their own high capacity facilities, the consolidations of AT&T and MCI with facilities-based access providers will result in the merged companies now competing head-to-head with U S WEST in the Seattle area market for high capacity services. Therefore, AT&T and MCI have an incentive to oppose U S WEST's Petition purely for their own business purposes.

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<sup>48</sup> [http://investor.mci.com/merger\\_overview/merger2.htm](http://investor.mci.com/merger_overview/merger2.htm).

Kahn and Tardiff observe that “[i]t would be difficult to conceive of a more substantial consequent diminution of whatever market power U S WEST might previously have enjoyed.”<sup>50</sup>

## 2. Market Share

U S WEST’s steadily declining market share for high capacity services in the Seattle MSA supports the conclusion that U S WEST lacks market power.<sup>51</sup> Quality Strategies uses DS1 equivalents as the basis for its market share calculations because DS1 bandwidth is deemed the baseline for the high capacity services market.<sup>52</sup> As discussed above, the high capacity services market encompasses both voice and data traffic, and wireline and wireless technologies. For analytical purposes, Quality Strategies describes the Seattle area market for high capacity services as a three-tier market, with U S WEST and other providers selling services to end users, resellers and other carriers for transport purposes.<sup>53</sup> As depicted below, this market can be sub-divided based on who high capacity services are sold to – retail and wholesale segments – versus who is ultimately using the underlying facilities – the “provider” and “transport” segments.<sup>54</sup>

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<sup>49</sup> Communications Daily, July 27, 1998.

<sup>50</sup> Attachment C, Kahn and Tardiff Paper at 8.

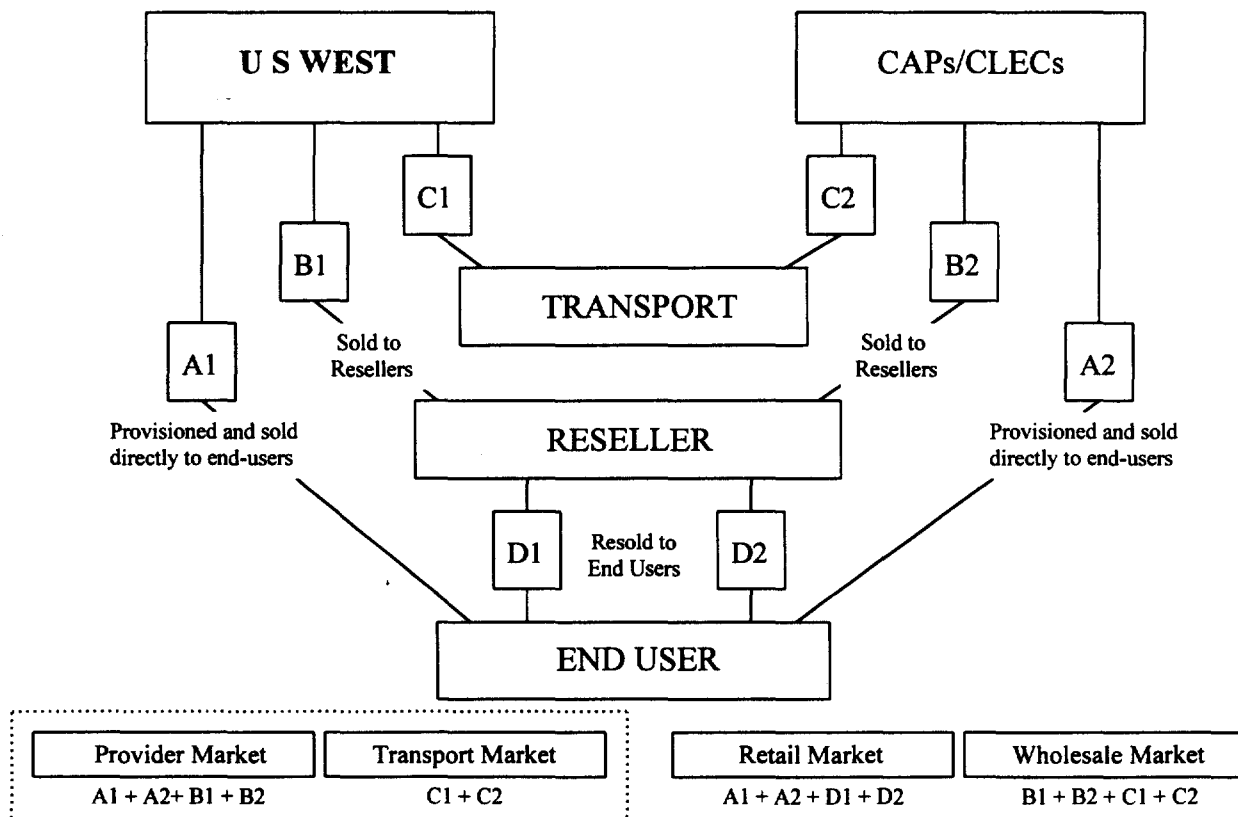
<sup>51</sup> See AT&T Reclassification Order, 11 FCC Rcd. at 3307 ¶ 67.

<sup>52</sup> Attachment A, Qualities Strategies Report at 25.

<sup>53</sup> Id. at 2-4.

<sup>54</sup> Id.





The attached market analysis conducted by Quality Strategies shows that competitive providers have captured almost 80 percent of the retail market for high capacity services.<sup>55</sup> This is the most important market share statistic because it identifies the carrier that has the direct account relationship with the customer. In fact, the customer may not even be aware of the identity of the carrier actually provisioning the underlying high capacity facilities. Therefore, the retail services provider has a significant marketing advantage over U S WEST even when it is the underlying facilities provider. For all competitors in the Seattle MSA, other than U S WEST, the retail service provider can take advantage of its relationship with the customer to offer a full service package which includes interLATA voice and

<sup>55</sup> Id. at 11.

data services.

The Commission has acknowledged the fact that competitive entry of resellers, some of which may grow to become regional or even national facilities-based competitors, puts downward pressure on prices.<sup>56</sup> In its recent decision denying Personal Communications Industry Association's petition for forbearance from enforcing the resale rule as applied to PCS providers, the Commission stated that resellers exert downward pressure on rates through their ability to purchase services at high volume rates and pass through those savings to their customers.<sup>57</sup> The Commission also noted that resellers are able to offer their customers packages of services, some or all of which may be obtained from other providers, thereby enabling resellers to tailor service packages to meet each customer's particular mix of needs.<sup>58</sup> As discussed above, resellers of high capacity services enjoy a significant competitive advantage over U S WEST because of their ability to offer a full service package that includes interLATA services.

Moreover, expansion of competitive providers' business has been even more rapid than the impressive 12 percent growth in the demand for high capacity

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<sup>56</sup> AT&T Reclassification Order, 11 FCC Rcd. at 3304 ¶ 61; In the Matter of Personal Communications Industry Association's Broadband Personal Communications Services Alliance's Petition for Forbearance For Broadband Personal Communications Services, Memorandum Opinion and Order and Notice of Proposed Rulemaking, 13 FCC Rcd. 16857, 16874-75 ¶ 35 (1998) ("PCIA Forbearance Order").

<sup>57</sup> Id.

<sup>58</sup> Id.

services in the Seattle market.<sup>59</sup> During the period from the fourth quarter of 1994 to the fourth quarter of 1997, the competitive providers' market share of the provider segment (i.e., high capacity services ultimately purchased by end users) increased from less than 20 percent to 35 percent.<sup>60</sup> The competitive providers' market share of the transport segment (i.e., high capacity services purchased by carriers for transport) also is growing rapidly. Perhaps the most significant trend statistic is the fact that, between the second and fourth quarters of 1997, competitive providers captured 65 percent of the growth in demand of the provider segment and 78 percent of the growth in demand of the transport segment.<sup>61</sup> Share of growth is the primary indicator of what a competitor's installed-base market share will look like in the future – and competitive providers in the Seattle MSA have captured a majority share of market growth over the past several years.<sup>62</sup>

U S WEST's rapid reduction in market share is largely the result of facilities build-out on the part of competitive providers in the Seattle area and their focus on the large business market. U S WEST's share of the facilities-provider market segment is likely to decrease rapidly as customers, particularly the largest carrier customers, migrate traffic onto their own fiber networks.<sup>63</sup> As discussed above, U S WEST already is feeling the impact of this migration. Kahn and Tardiff also

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<sup>59</sup> Attachment C, Kahn and Tardiff Paper at 9. With this rate of growth, demand for high capacity services will double in about 6 years. Id. at n.19.

<sup>60</sup> Attachment A, Quality Strategies Report at 10.

<sup>61</sup> Id. at 9.

<sup>62</sup> Id.

<sup>63</sup> Id. at 18-19.

assert that the recent strong growth in competitive provider market share is likely to continue, and may even accelerate, given the rapid growth of competitive provider market share nationwide.<sup>64</sup> They note that, during the first quarter of 1998, competitive providers added more business lines nationwide than the Regional Bell Operating Companies ("RBOC").<sup>65</sup>

Kahn and Tardiff compare the Seattle area market share information with the situation the Commission considered when it granted AT&T non-dominant status for interstate long distance. While U S WEST's overall share of the Seattle area market for high capacity services is higher than AT&T's share of the long distance market when the Commission found AT&T to be non-dominant (73 percent compared to 60 percent), U S WEST's market share of the retail segment is much lower than AT&T's.<sup>66</sup> According to Kahn and Tardiff, "we doubt there would be economists prepared to refer to a firm with 20 percent of a retail market as 'dominant.'"<sup>67</sup> Moreover, for both the retail and wholesale market segments, competitive providers' shares and volumes of the high capacity business in the Seattle area are growing at a considerably more rapid rate than were AT&T's competitors' shares and volumes of the long distance business.<sup>68</sup> In their study,

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<sup>64</sup> Attachment C, Kahn and Tardiff Paper at 10-11.

<sup>65</sup> Id. at 10 (citing Statement of Heather Gold, FCC En Banc on State of Local Competition, January 29, 1998 and Salomon Smith Barney "CLECs Surpass Bells in Net Business Line Additions for the First Time," May 6, 1998).

<sup>66</sup> Id. at 11.

<sup>67</sup> Id.

<sup>68</sup> Id.

Kahn and Tardiff's state that "the consensus of economic opinion would place greater emphasis on changes in market shares over time and shares in incremental business than their absolute levels."<sup>69</sup> Accordingly, their conclusion is that U S WEST has a much stronger case for claiming a lack of market power in the Seattle area market for high capacity services than did AT&T.<sup>70</sup>

### 3. Demand Elasticity

Demand elasticity refers to the willingness and ability of a carrier's customers to switch to a competitive provider, or to otherwise change the amount of services they purchase from the carrier in response to a change in the price or quality of the services. High demand elasticity indicates that customers are willing and able to switch to another service provider in order to obtain price reductions or desired features. It also indicates that the particular service market is subject to competition.<sup>71</sup>

In granting non-dominant status to AT&T, the Commission observed that the demands of business customers are highly elastic because they are sophisticated buyers who typically receive and consider alternative proposals from several vendors.<sup>72</sup> They also are likely to engage in long-term planning and ordering.<sup>73</sup> The Commission's observation with respect to long distance services clearly applies with

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<sup>69</sup> Id.

<sup>70</sup> Id.

<sup>71</sup> Comsat Reclassification Order, 13 FCC Rcd. at 14120 ¶ 71.

<sup>72</sup> AT&T Reclassification Order, 11 FCC Rcd. at 3306 ¶ 65.

<sup>73</sup> Comsat Reclassification Order, 13 FCC Rcd. at 1410-21 ¶ 72.

at least as much force to the segment of the business customer market that purchases high capacity services and facilities – medium to large business customers, governmental entities and other carriers.<sup>74</sup>

In support of their conclusion, Kahn and Tardiff reference the economic analysis prepared by Professor Michael E. Porter that AT&T submitted with its request for non-dominant status.<sup>75</sup> Professor Porter found that business customers have considerable negotiating power because of their sophisticated knowledge of telecommunications, their use of outside network consultants, and their ability to provision their own network facilities.<sup>76</sup> Kahn and Tardiff conclude that these factors “are even more powerful in the case of high capacity services” because of the fact that the primary users of these services – other carriers – have both the incentive and the ability to drive a hard bargain for good prices and levels of service by the threat of going elsewhere.<sup>77</sup> The ability of U S WEST’s largest carrier

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<sup>74</sup> Attachment C, Kahn and Tardiff Paper at 12.

<sup>75</sup> Id. (citing Michael E. Porter, Competition in the Long-Distance Telecommunications Market, September 1993). Kahn and Tardiff note that the Commission cited the Porter Study when concluding that demand elasticity considerations supported the conclusion that AT&T was non-dominant in the long distance market. Id. at n.28.

<sup>76</sup> The fact that U S WEST normally provides high capacity services under term agreements (as do other providers) does not present a barrier to competition in a fast growing market such as the Seattle MSA. While approximately 70 percent of U S WEST’s high capacity revenues are subject to term agreements, half of these revenues are subject to minimal termination liability charges (i.e., 15 percent) and two-thirds of these revenues are subject to agreements expiring in 36 months or less.

<sup>77</sup> Attachment C, Kahn and Tardiff Paper at 12-13.

customers to migrate high capacity traffic to their own affiliated fiber networks further increases their bargaining ability in the marketplace.

As Kahn and Tardiff note, these demand elasticity factors are further reinforced by the already high market share U S WEST's competitors have in the retail segment of the Seattle area market for high capacity services and the rapid growth of the competitors' market share in the provider and transport segments of the market.<sup>78</sup> Given that the actual provider of the underlying high capacity facilities is often unknown to the end-user customer, U S WEST's retail competitors can take advantage of their customer relationships to become the customer's facilities provider and to acquire additional business.<sup>79</sup> Moreover, so long as U S WEST remains subject to the prohibition in offering interLATA services, the ability of competitive providers to offer a complete package of telecommunications services which includes interLATA voice and data services gives them a "great advantage" over U S WEST in the marketplace.<sup>80</sup>

#### 4. Supply Elasticity

Supply elasticity refers to the ability of suppliers in a given market to increase the quantity of services supplied in response to an increase in price. There are two factors that determine supply elasticities in the market. The first is the supply capacity of existing competitors, because supply elasticities tend to be high if existing competitors have or can easily acquire additional capacity in a relatively

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<sup>78</sup> Id. at 13.

<sup>79</sup> Id. 12-13.

<sup>80</sup> Id. at 14.

short time period.<sup>81</sup> The second factor is the existence of low barriers to entry, because supply elasticities tend to be high if new suppliers can enter the market relatively easily and add to existing capacity.

PEI has determined that U S WEST's competitors have more than sufficient readily available excess capacity to constrain U S WEST's pricing behavior. As a group, the three facilities-based competitors included in Quality Strategies' analysis have installed more than 700 route miles of optical fiber in the Seattle MSA.<sup>82</sup> With current technology, these competitive fiber networks should be capable of transporting more traffic than the Seattle area will ever generate. Indeed, equipped as they are today, the competitive fiber backbone networks have more than sufficient capacity to accommodate the current demand for U S WEST's high capacity service.<sup>83</sup>

The only real constraint on expanding service to U S WEST's customers in the near-term is the need to build facilities to connect these sites to their fiber backbone networks. In most cases, this is not a major obstacle. Approximately 61 percent of U S WEST's current high capacity demand in the Seattle area is located within 100 feet of existing competitive provider fiber networks, which means that it can be absorbed easily and in a relatively short time.

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<sup>81</sup> Comsat Reclassification Order, 13 FCC Rcd. at 14123-124 ¶ 78.

<sup>82</sup> Attachment A, Quality Strategies Report at 20. Attachment D hereto is a map illustrating the existing competitive provider fiber backbone networks in the Seattle area.

<sup>83</sup> Attachment B, PEI Study at 25.



Moreover, as the attached report prepared by PEI demonstrates, competitive providers would not incur significant costs to extend their fiber networks to absorb the vast majority of U S WEST's current high capacity demand. Specifically, competitive providers in Seattle can serve the almost 60 percent of U S WEST's high capacity customer locations within 1,000 feet of their existing fiber networks – which accounts for approximately 67 percent of U S WEST's current high capacity demand in the Seattle area – if they invest \$46 million.<sup>84</sup> In addition, competitive providers can serve all of U S WEST's high capacity customer locations within 9,000 feet of their existing fiber networks – which accounts for more than 90 percent of U S WEST's current high capacity demand in the Seattle area – if they invest approximately \$110 million.<sup>85</sup> As wireless technology continues to develop, high capacity fixed wireless alternatives will provide an alternative, low-cost means of expanding these competitive fiber backbone networks.<sup>86</sup>

To put these figures into prospective, Kahn and Tardiff observe that U S WEST's current high capacity customers generate about \$52 million of revenue annually in direct charges for high capacity facilities (i.e., for the “dial tone” alone).<sup>87</sup> This means that, based on plausible assumptions, the investment necessary to serve all U S WEST's current business would be about 2.2 times revenues – a

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<sup>84</sup> Id. at 3. Attachment E hereto is a map showing competitive provider coverage of U S WEST's DS1 equivalent services, including a buffer area within 1,000 feet of existing competitive provider fiber networks.

<sup>85</sup> Attachment B, PEI Study at 3.

<sup>86</sup> See id. at 17.

<sup>87</sup> Attachment C, Kahn and Tardiff Paper at 16.

multiple “markedly lower” than U S WEST’s current investment to revenue multiple of 3.4 for Washington.<sup>88</sup> The investment ratios required for competitive providers to reach those customers located within 1,000 feet of the providers’ existing fiber networks would be even more favorable.<sup>89</sup>

The investment to revenue comparisons are somewhat hypothetical exercises for considering whether competitive providers would find it economical to expand their networks to serve U S WEST’s existing high capacity demand if it were to become available.<sup>90</sup> As such, the comparisons do not take into account the lost economies of scale and density that competitive providers would likely experience if they expand selectively to serve high volume/low cost locations.<sup>91</sup> On the other hand, Kahn and Tardiff state that focusing on scale economies sacrificed by targeting customers actually understates the attractiveness of serving current U S WEST high capacity locations, for two reasons.<sup>92</sup> First, because the high capacity market is growing, competitive providers can realize economies of scale by serving the incremental demand in addition to demand captured from U S WEST.<sup>93</sup> Second, it is important to recognize that the revenue figures only reflect payments for the use of the high capacity facilities – as such, they do not take into account the fact that competition increasingly involves the provision of a package of services

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<sup>88</sup> Id.

<sup>89</sup> Id.

<sup>90</sup> Id. at 17.

<sup>91</sup> Id.

<sup>92</sup> Id. at 17-18.

(i.e., one-stop shopping).<sup>94</sup> Competitive providers that obtain access to a customer through their high capacity business have a vehicle for obtaining access to other higher margin services. This means that competitors may be willing to underprice their high capacity services in order to “capture” the customer. Taking the net revenues from bundled services into account would make the investment to revenue comparisons “markedly more favorable” according to Kahn and Tardiff.<sup>95</sup>

Another important consideration in assessing supply elasticity is the timeliness with which current competitors can expand facilities to meet new demand. PEI estimates that competitive providers can serve the 60 percent of current U S WEST-served locations that are within 1,000 feet of the providers’ existing fiber networks in 18 to 24 months.<sup>96</sup> Kahn and Tardiff find that this time frame is “very significant” and consistent with the time frame envisioned in the Merger Guidelines for determining whether prospective new investments should be counted as a competitive presence disciplining the pricing behavior of firms contemplating a merger.<sup>97</sup> Although serving those customers beyond 1,000 feet would require additional time, the competitive providers’ ability to do so is

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<sup>93</sup> Id. at 17.

<sup>94</sup> Id. at 17-18. For example, ELI’s President and Chief Operating Officer Dave Sharkey stated in a news release dated May 4, 1998: “We are witnessing the success of our bundled service strategy, as nearly 60% of our customers purchased multiple products and services.” PR Newswire Association, Inc., May 4, 1998.

<sup>95</sup> Attachment C, Kahn and Tardiff Paper at 18.

<sup>96</sup> Attachment B, PEI Study at 3.

<sup>97</sup> Attachment C, Kahn and Tardiff Paper at 18.

“competitively significant” according to Kahn and Tardiff.<sup>98</sup>

The impressive growth of competitive provider’s market share in the Seattle area market for high capacity services demonstrates that the cost of entry is not prohibitive.<sup>99</sup> This growth is reflected in tremendous growth in the number and size of competitive providers nationwide. In addition, competitive providers have been attractive takeover targets and are having no trouble attracting large amounts of capital in the financial market. For example, ELI went public in November 1997 and raised \$128 million in its equity offering.<sup>100</sup> Kahn and Tardiff note that, in the two years since the passage of the 1996 Act, competitive providers have raised \$14 billion of outside capital, whereas total annual investment by incumbent LECs has been about \$19 billion.<sup>101</sup>

Nor are there legal barriers to entry.<sup>102</sup> Competitive providers have other market entry options in those areas where they choose not to deploy facilities. With the adoption of the 1996 Act, Congress implemented a comprehensive system of market-opening provisions that benefit both facilities-based carriers and pure resellers. For example, in the Seattle MSA, competitive providers have collocated in 21 of the 25 central offices (or 84 percent). Through these collocations,

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<sup>98</sup> Id.

<sup>99</sup> Id. at 19.

<sup>100</sup> ELI also has a \$400 million credit line, guaranteed by its parent company, Citizen’s Utilities, which has an A+ rating with Standard & Poors. Citizen’s other securities carry ratings that range from AA- to AA+.

<sup>101</sup> Attachment C, Kahn and Tardiff Paper at 21.

<sup>102</sup> Compare Comsat Reclassification Order, 13 FCC Rcd. at 14125 ¶ 82.

competitors have access to more than 92 percent of all the access lines in the Seattle MSA. Also competitive providers also enjoy flexibility to increase their market presence through resale beyond the reach of their existing fiber networks. It also allows them to increase their market share more quickly than would be possible solely through expansion of their own networks.

5. U S WEST's Cost, Structure, Size and Resources

In the AT&T Reclassification Order, the Commission addressed the question of whether AT&T's size relative to other carriers might give it a significant advantage in terms of scale economies and access to capital.<sup>103</sup> U S WEST does not enjoy any such advantage in the Seattle area market for high capacity services. While the Commission considered the fact that AT&T faced at least two "full-fledged facilities-based competitors" in the long distance market,<sup>104</sup> U S WEST faces three established facilities-based competitors in the Seattle MSA and numerous additional new entrants. As discussed above, the combined AT&T/TCG and MCI/MFS WorldCom entities have a significant advantage in terms of scale economies and access to capital, not to mention the advantage of being able to provide interLATA services.

According to the Kahn and Tardiff Paper, the continued feasibility and vitality of competitive entry in the Seattle area market for high capacity services is

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<sup>103</sup> AT&T Reclassification Order, 11 FCC Rcd. at 3309 ¶ 73. The Commission recently held that Comsat does not have market power, notwithstanding its finding that Comsat has competitive advantages in size and access to resources. Comsat Reclassification Order, 13 FCC Rcd. at 14131-132 ¶ 93.

<sup>104</sup> AT&T Reclassification Order, 11 FCC Rcd. at 3308 ¶ 70.

shown by the fact that the rapid expansion of competitive entry has occurred at the same time as U S WEST charges for high capacity services have substantially declined.<sup>105</sup> In fact, when the first competitive providers entered the high capacity services market in the late-1980s, prices for high capacity services were approximately twice their current levels.<sup>106</sup> The fact that competitive activity in the market is accelerating while prices for services are dropping is a strong indication that investors do not believe incumbents have an insurmountable cost advantage in the market.<sup>107</sup>

C. U S WEST Lacks The Ability To Exercise Market Power  
In The Seattle Market For High Capacity Services

The Commission has consistently held that a carrier is to be declared dominant only if it possesses market power in the relevant product and geographic market.<sup>108</sup> Conversely, a carrier qualifies as non-dominant if it lacks market power in the relevant market.<sup>109</sup> In making a determination about whether a carrier has market power, the Commission analyzes whether the carrier has the ability to “raise prices above competitive levels and maintain that price for a significant period, reduce the quality of the relevant product or service, reduce innovation or

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<sup>105</sup> Attachment C, Kahn and Tardiff Paper at 21.

<sup>106</sup> Id. at 21. For example, U S WEST’s rates for DS1 service fell by 58% from 1989 to 1998. Id. at n.51.

<sup>107</sup> Id. at 21-22.

<sup>108</sup> AT&T Reclassification Order, 11 FCC Rcd. at 3346 ¶ 138.

<sup>109</sup> Id.

restrict output profitably.”<sup>110</sup>

Applying this standard to the evidence accumulated by U S WEST leads to the conclusion that U S WEST lacks the ability to exercise market power in the Seattle area market for high capacity services. Following the approach the Commission previously used to assess market power for other services, Kahn and Tardiff conclude that the market for high capacity services in Seattle “fully exhibits the indicia of competition that the Commission has prescribed.”<sup>111</sup> In particular, Kahn and Tardiff rely on the following market characteristics: (1) U S WEST has a diminishing market share, serving only 20 percent of the retail market and providing one-third of the facilities that serve new demand; (2) customers (e.g., large businesses and other carriers) are highly sensitive to price and other service characteristics; (3) U S WEST’s competitors have the ability to expand their facilities and capture U S WEST’s existing business, and there are minimal barriers to entry; and (4) U S WEST’s size does not provide it an insurmountable advantage.<sup>112</sup> In light of U S WEST’s lack of market power, Kahn and Tardiff conclude that “[c]ompetition itself, without dominant firm regulation, is sufficient to deny U S WEST the ability to impose anticompetitive prices and other conditions.”<sup>113</sup>

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<sup>110</sup> Comsat Reclassification Order, 13 FCC Rcd. at 14118-119 ¶ 67; see also In the Matter of The Merger of MCI Communications Corporation and British Telecommunications plc, Memorandum Opinion and Order, 12 FCC Rcd. 15351, 15398 ¶ 124 (1997); Bell Atlantic/NYNEX Order, 12 FCC Rcd. at 20038 ¶ 101.

<sup>111</sup> Attachment C, Kahn and Tardiff Paper at 1.

<sup>112</sup> See id. at 22.

<sup>113</sup> Id. at 26.

### III. FORBEARANCE FROM DOMINANT CARRIER REGULATION OF U S WEST IN THE SEATTLE MARKET FOR HIGH CAPACITY SERVICES IS WARRANTED

Section 10 of the 1996 Act requires that the Commission “forbear from applying any regulation or any provision of this [Act] to a telecommunications carrier or telecommunications service, or class of telecommunications carriers or telecommunications services, in any or some of its or their geographic markets” if the Commission finds that:

- (1) enforcement of such regulation or provision is not necessary to ensure that the charges, practices, classifications, or regulations by, for, or in connection with that telecommunications carrier or telecommunications service are just and reasonable and are not unjustly or unreasonably discriminatory;<sup>114</sup>
- (2) enforcement of such regulation or provision is not necessary for the protection of consumers;<sup>115</sup> and
- (3) forbearance from applying such provision or regulation is consistent with the public interest.<sup>116</sup>

In making the public interest determination, Section 10 requires that the Commission consider whether forbearance will promote competitive market conditions, including the extent to which forbearance will enhance competition among providers of telecommunications services.<sup>117</sup>

Based on the compelling economic evidence of the preceding section, U S WEST requests that the Commission forbear from regulating it as a dominant

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<sup>114</sup> 47 U.S.C. § 160(a)(1).

<sup>115</sup> 47 U.S.C. § 160(a)(2).

<sup>116</sup> 47 U.S.C. § 160(a)(3).

<sup>117</sup> 47 U.S.C. § 160(b).



carrier in the Seattle area market for high capacity services. In particular, U S WEST seeks forbearance from the following Commission regulations: (1) the requirement that incumbent LECs (but not providers other than incumbent LECs) must file tariffs for interstate access services;<sup>118</sup> (2) Sections 61.38 and 61.41-61.49, which require dominant carriers to file tariffs on up to 15-days notice with cost support;<sup>119</sup> (3) Section 69.3(e)(7), which requires averaged rates within a study area;<sup>120</sup> (4) Sections 61.41-61.49, and 65, which impose price cap and rate of return regulation on dominant carriers;<sup>121</sup> and (5) any other rules that apply to U S WEST, but not other providers, in the Seattle area market for high capacity services.

A. Dominant Carrier Regulation Of U S WEST's High Capacity Services In Seattle Is Not Necessary To Ensure That Rates And Practices Are Just, Reasonable, And Not Unreasonably Discriminatory

The first statutory criterion for forbearance requires that the Commission determine whether dominant carrier regulation of U S WEST's high capacity services in the Seattle MSA is necessary to ensure that rates and practices are just, reasonable and not unreasonably discriminatory. As the Commission recognized, it is "highly unlikely" that carriers lacking market power could successfully charge rates that violate the Act, because an attempt to do so would prompt customers to

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<sup>118</sup> See CAP Forbearance Order, 12 FCC Rcd. at 8596 (forbearing from requiring non-incumbent LEC providers of exchange access services to file tariffs).

<sup>119</sup> 47 C.F.R. §§ 61.38, 61.41-61.49.

<sup>120</sup> 47 C.F.R. § 69.3(e)(7).

<sup>121</sup> 47 C.F.R. §§ 61.41-61.49, 47 C.F.R. § 65.

switch to different carriers.<sup>122</sup> For that reason, the Commission has determined that tariffing is not necessary to ensure reasonable rates for carriers that lack market power.<sup>123</sup> In this case, the market for high capacity services in the Seattle MSA is sufficiently competitive that there is no reason to regulate any carrier as dominant.

In the preceding section, U S WEST demonstrated that it does not possess market power in the Seattle area market for high capacity services. Therefore, it should not be required to file dominant carrier tariffs and comply with other dominant carrier regulations, such as the rate averaging requirement. Rather, as is the case for every other non-dominant carrier in the high capacity market, U S WEST should be subject to permissive detariffing, which would allow, but not require, the filing of tariffs on one-day's notice with a presumption of lawfulness and without any cost support.<sup>124</sup> Marketplace forces will effectively preclude U S WEST from charging unreasonable rates for high capacity services in the Seattle MSA.

Moreover, other regulations are sufficient to ensure that U S WEST does not attempt to charge unreasonable rates. In particular, Sections 201 and 202 of the

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<sup>122</sup> PCIA Forbearance Order, 13 FCC Rcd. at 16885 ¶ 57 (citing CAP Forbearance Order, 12 FCC Rcd. at 8608 ¶ 23; In the Matter of Policy and Rules Concerning the Interstate, Interexchange Marketplace, Second Report and Order, 11 FCC Rcd. 20730, 20742-47 ¶¶ 21-28 (1996) ("IXC Forbearance Order")).

<sup>123</sup> CAP Forbearance Order, 12 FCC Rcd. at 8608 ¶ 23; IXC Forbearance Order, 11 FCC Rcd. at 20742-43 ¶ 21.

<sup>124</sup> CAP Forbearance Order, 12 FCC Rcd. at 8610 ¶ 27. It should be noted that the Commission tentatively concluded that it should adopt mandatory detariffing for interstate exchange access services, as it previously adopted for interexchange services. Id. at 8613 ¶ 34.

Act require that rates and practices be just, reasonable, and not unreasonably discriminatory.<sup>125</sup> The Commission can address any issue of unlawful rates or practices through the exercise of its authority to investigate and adjudicate complaints under Section 208.<sup>126</sup> As the Commission recently noted, Sections 201 and 202 provide important safeguards for consumers in areas that have been deregulated by the Commission.<sup>127</sup> In those circumstances where the Commission has reclassified carriers as non-dominant because they lack market power and reduced those carriers' regulatory burden, the Commission has continued to require compliance with Sections 201 and 202.<sup>128</sup>

It is also important to recognize that U S WEST is not seeking to impose restrictions on the resale of its high capacity facilities. The Commission has recognized that resellers exert downward pressure on rates through their ability to purchase service at high volume rates and pass through those savings to their customers.<sup>129</sup> In the Seattle area market for high capacity services, where competitive providers already have captured 80 percent of the retail market segment, resellers clearly have the ability to exert such pressure. Thus, grant of U S WEST's Petition would not weaken the market forces that restrain U S WEST's ability to charge unreasonable rates.

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<sup>125</sup> 47 U.S.C. §§ 201(b), 202(a).

<sup>126</sup> 47 U.S.C. § 208(a).

<sup>127</sup> PCIA Forbearance Order, 13 FCC Rcd. at 16872 ¶ 31.

<sup>128</sup> Id. at 16866 ¶ 17.

<sup>129</sup> Id. at 16874-875 ¶ 35.

B. Dominant Carrier Regulation Of U S WEST's Dedicated High Capacity Services In Seattle Is Not Necessary To Protect Consumers

The second statutory criterion for forbearance requires that the Commission determine whether dominant carrier regulation of U S WEST's high capacity services in Seattle is necessary for the protection of consumers. As demonstrated in the previous section, dominant carrier regulation is not necessary to assure that U S WEST's rates and practices are just, reasonable and not unreasonably discriminatory. Because U S WEST lacks market power, rates for high capacity services will be effectively constrained by market forces. Further, the requirements of Sections 201 and 202 serve as an additional safeguard for consumers. Therefore, dominant carrier regulation of U S WEST also is not necessary to protect high capacity consumers from unreasonable rates or discriminatory practices. In fact, high capacity customers are being deprived of many of the benefits of competition in the Seattle area market for high capacity services because of the continued regulation of U S WEST as a dominant carrier. Accordingly, the second criterion is satisfied.<sup>130</sup>

C. Forbearance From Applying Dominant Carrier Regulation To U S WEST's High Capacity Services In Seattle Is Consistent With The Public Interest

The third statutory criterion for forbearance requires that the Commission determine whether forbearance from applying dominant carrier regulation to U S WEST's high capacity services in the Seattle MSA is consistent with the public interest. In making this public interest determination, the Commission considers

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<sup>130</sup> Id. ¶ 58; CAP Forbearance Order, 12 FCC Rcd. at 8609-10 ¶ 26.

whether forbearance will “promote competitive market conditions, including the extent to which forbearance will enhance competition among providers of telecommunications services.”<sup>131</sup> Continuing to regulate U S WEST as a dominant carrier in the Seattle area market for high capacity services results in competitive distortions that do not serve the public interest.

In the AT&T Reclassification Order, the Commission graphically described the significant social costs of continued asymmetrical regulation: (1) the longer tariff notices imposed on AT&T dampened its incentives to innovate because rivals could respond to innovations before they were allowed to go into effect; (2) the tariff filing requirements also dampened AT&T’s incentives to reduce prices; (3) AT&T’s competitors could use the asymmetrical regulatory process to delay and undermine its initiatives; and (4) regulation imposed administrative costs on both AT&T and the Commission.<sup>132</sup>

Kahn and Tardiff conclude that dominant carrier regulation of U S WEST in the Seattle market for high capacity services market involves the same kinds of social costs.<sup>133</sup> The 15-day tariff notice requirement, which applies only to U S WEST, gives competitive providers the opportunity to respond to U S WEST’s

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<sup>131</sup> Comsat Reclassification Order, 13 FCC Rcd. at 14157 ¶ 151; see also PCIA Forbearance Order, 13 FCC Rcd. at 16870 ¶ 27.

<sup>132</sup> Attachment C, Kahn and Tardiff Paper at 22 (citing AT&T Reclassification Order, 11 FCC Rcd. at 3290-91 ¶ 32); see also PCIA Forbearance Order, 13 FCC Rcd. at 16871-872 ¶ 30 (Forbearance with regard to broadband PCS carriers alone would create regulatory asymmetry with respect to cellular and other CMRS providers that would “distort competition and contradict the intent of Congress that CMRS providers should be treated similarly.”)

<sup>133</sup> Attachment C, Kahn and Tardiff Paper at 22-24.

filed rate or be the first to market with a new service offering even before U S WEST's tariff becomes effective. Further, as a dominant carrier, U S WEST also is prohibited from responding to competition by charging deaveraged rates within the study area. If anything the social costs of dominant carrier regulation are compounded by the fact that U S WEST is prohibited from responding to competitive providers' bundled offerings, which may include interLATA voice and data services.<sup>134</sup>

Moreover, continuing to regulate U S WEST as a dominant carrier in a competitive market results in "umbrella" pricing, where competitors argue that U S WEST's proposed tariff rates are unlawfully low while pricing their own services below U S WEST's tariffed rates. The Commission has recognized that requiring tariff filings may facilitate tacit collusion by enabling carriers to "ascertain competitors' prices and any changes to rates, which might encourage carriers to maintain rates at an artificially high level."<sup>135</sup> In comparison, forbearance of the tariff filing requirements "will foster competition which will expand the consumer benefits of a competitive marketplace."<sup>136</sup> Thus, dominant carrier regulation reduces the incentive of all competitors to initiate price reductions and new services, and adversely affects U S WEST's ability to respond

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<sup>134</sup> Id. Kahn and Tardiff observe that, ironically, the incumbent LECs' Section 271 applications are being held-up pending demonstration that local markets are sufficiently open to competition. Id.

<sup>135</sup> Implementation of Sections 3(n) and 332 of the Communications Act, Regulatory Treatment of Mobile Services, Second Report and Order, 9 FCC Rcd. 1411, 1479-80 (1994).

<sup>136</sup> Id.

quickly and creatively to competition.

Dominant carrier regulation also imposes significant compliance costs on U S WEST and administrative costs on the Commission which are unnecessary in a competitive environment. The submission of detailed cost support with each tariff filing increases the cost of implementing new services and rate structures. These regulatory costs are passed through to high capacity consumers in the form of higher rates. Because U S WEST is the only competitor in the Seattle area market for high capacity services that is forced to incur the regulatory costs associated with dominant carrier regulation, it suffers a unique competitive disadvantage. In comparison, permissive detariffing of these services “would reduce administrative burdens on [U S WEST] and on the Commission, promote competitive market conditions, facilitate provision of new service offerings, and promote market entry.”<sup>137</sup>

The Kahn and Tardiff Paper addresses some of the broader public interest issues at stake in this proceeding. In order to ensure the continued development and modernization of the public switched telephone network and the availability of sophisticated and innovative services – both of which are the central goals of the 1996 Act – all competitors, including incumbents, must be free from restrictions and handicaps on their ability to compete in the marketplace.<sup>138</sup> Moreover, all competitors must be given the “full, undiluted incentives of a free market system” to

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<sup>137</sup> PCIA Forbearance Order, 13 FCC Rcd. at 16888-889 ¶ 64 (comparing CAP Forbearance Order, 12 FCC Rcd. at 8610-12 ¶¶ 27-32).

<sup>138</sup> Attachment C, Kahn and Tardiff Paper at 22.

undertake the typically risky investments needed to drive innovation.<sup>139</sup>

Kahn and Tardiff describe two types of free market incentives. The first type is the stimulus of competition itself.<sup>140</sup> The strongest case for substituting competition for regulation is the superior ability of the former to exert pressure on all competitors in the Seattle area market for high capacity services to be efficient and innovative if they are to survive, let alone prosper.<sup>141</sup> Kahn and Tardiff identify two illustrations of this effect: (1) the wholesale adoption of hub and spoke operations and the development of computerized reservation systems by the airlines after their deregulation; and (2) the widespread adoption of just-in-time inventory systems made possible only by deregulation which gave truckers the freedom to enter into bidding contracts with penalties for failure to perform according to stipulated standards.<sup>142</sup>

The second type is the self-interest of competitors, freed from continuing restrictions on the services and innovations they are permitted to offer.<sup>143</sup> In order to encourage innovation, competitors must be able to retain the profits from innovations that are successful, just as they are forced to bear the full cost of innovations that are failures. This symmetry can be achieved only through genuine

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<sup>139</sup> Id.

<sup>140</sup> Id. at 23.

<sup>141</sup> Id.

<sup>142</sup> Id.

<sup>143</sup> Id.



deregulation.<sup>144</sup>

As competition continues to develop in markets previously protected by regulation, the Commission should not weaken market-based incentives in a misguided effort to stimulate competition. Kahn and Tardiff point out that attempts to micromanage the process of deregulation, as has occurred in other industries, are more likely to produce distortions than to actually encourage efficient competition.<sup>145</sup> Ultimately, the Commission's incentive system should shrink regulatory restrictions to the absolute minimum and entrust protection of the public to a deregulated, competitive marketplace.<sup>146</sup>

The Commission's own experience with AT&T and the long distance industry demonstrates the public interest benefits of a free market system. At the time, the Commission's decision to reclassify AT&T as non-dominant was strongly opposed by AT&T's competitors. However, the Commission recognized that allowing AT&T to compete on equal terms with its competitors would spur increased competition in the long distance market. AT&T has continued to lose market share since it was declared non-dominant in 1995 while its competitors have thrived, indicating that the reclassification has not harmed competition.<sup>147</sup> Likewise, symmetrical regulation of U S WEST and competitive providers as non-dominant carriers would serve the public interest by promoting competitive market conditions and

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<sup>144</sup> Id.

<sup>145</sup> Id. at 23.

<sup>146</sup> Id. at 23-24.

<sup>147</sup> Id. at 25.

facilitating the introduction of new service offerings, service enhancements, and price reductions.

IV. REGULATING U S WEST AS A NON-DOMINANT CARRIER  
IN THE PROVISION OF HIGH CAPACITY SERVICES  
IN SEATTLE IS NOT TOTAL DEREGULATION

U S WEST is not requesting that its high capacity services be totally deregulated – it is requesting only that the Commission exercise its Section 10 forbearance authority and regulate U S WEST as a non-dominant carrier in the Seattle area market for high capacity services. As discussed above, like other non-dominant carriers, U S WEST will still be subject to regulation under Title II of the Communications Act of 1934, as amended. For example, non-dominant carriers are required to offer interstate services under rates, terms and conditions that are just, reasonable and not unduly discriminatory.<sup>148</sup> In addition, non-dominant carriers are subject to the Commission's complaint process.<sup>149</sup> At this time, non-dominant carriers are also required to give notice prior to discontinuance, reduction or impairment of service.<sup>150</sup>

As a non-dominant carrier, however, U S WEST would enjoy streamlined regulation equal to that of all its competitors in the Seattle area market for high capacity services. First, U S WEST would be subject to permissive detariffing, which would allow, but not require, the filing of tariffs for interstate high capacity services on one-day's notice with a presumption of lawfulness and without any cost

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<sup>148</sup> 47 U.S.C. §§ 201(b), 202(a).

<sup>149</sup> 47 U.S.C. §§ 208(a).

<sup>150</sup> 47 U.S.C. § 214.

support. Second, U S WEST's high capacity services in the Seattle area would be removed from price cap and rate of return regulation, which are appropriate only for dominant carrier services. Third, U S WEST would be allowed to charge deaveraged rates for high capacity services within the Seattle MSA. The effect of granting U S WEST's Petition would be to place U S WEST on equal footing with all other competitors in the Seattle area market for high capacity services.

## V. CONCLUSION

Congress adopted Section 10 because it recognized that regulation is unnecessary, and indeed harmful, in a competitive market. Under Section 10, the Commission is required to eliminate regulations that are no longer necessary to ensure that rates and practices are just, reasonable and not unreasonably discriminatory. U S WEST has gathered substantial evidence in support of its Petition demonstrating that the market for high capacity services in the Seattle MSA is robustly competitive. In light of U S WEST's lack of market power, competition, without dominant carrier regulation, is sufficient to constrain U S WEST's ability to impose anti-competitive prices and other terms and conditions of service.

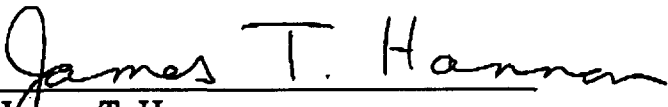
Section 10 also requires that the Commission consider whether forbearance will promote competitive market conditions. There is no question that allowing U S WEST to compete on equal footing with its competitors serves the public interest and enhances competition. Today, U S WEST is uniquely burdened by dominant carrier regulations that hamper its ability to freely compete in the Seattle area market for high capacity services. Removing these regulatory obstacles will

allow U S WEST to initiate price reductions and new services, and respond quickly and creatively to competition.

For these reasons, the Commission should grant U S WEST's Petition and exercise its authority to forbear from regulating U S WEST as a dominant carrier in the provision of high capacity services in the Seattle MSA.

Respectfully submitted,

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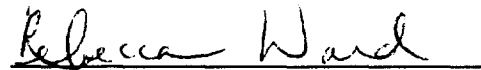
Its Attorneys

Of Counsel,  
Dan L. Poole

December 30, 1998

## **CERTIFICATE OF SERVICE**

I, Rebecca Ward, do hereby certify that on this 30<sup>th</sup> day of December, 1998, I have caused a copy of the foregoing **PETITION OF U S WEST COMMUNICATIONS, INC. FOR FORBEARANCE** to be served, via hand delivery, upon the persons listed on the attached service list.

  
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